In addition, many countries have recently permitted open entry for origination of international services, or will do so shortly. Foreign carriers facing imminent competition, including Telefónica de España, have been pressing their national governments to permit rapid rate rebalancing.

Recognizing increasing competition from call-back providers, country direct services and new entrants in the international services market, foreign carriers are pushing hard for rate rebalancing. Telefónica de España, Telefónica Argentina and Telintar have been campaigning aggressively for rate rebalancing for several years because it is in their own financial interest to do so.

C. Any FCC Push To Reduce Settlement Rates Should Be Tied To Rate Rebalancing

If the Commission persists on implementing settlement rate reform on a unilateral basis, then it must tie such reform to rate rebalancing for at least two critical reasons. **First**, tying settlement rate reductions to rate rebalancing recognizes the economic and political realities facing foreign carriers and foreign governments. As explained above, national governments have legitimate goals of improving infrastructure and broadening universal service. In addition, there are significant political forces in many countries that keep prices for domestic services below cost. Until foreign carriers are allowed to rebalance all of their rates on a more cost-oriented basis, it is not possible for them to make the radical changes in the settlement rates envisioned in the NPRM.

Second, tying settlement rate reductions to rate rebalancing aligns the Commission's goals with those of the foreign carrier. As demonstrated above, the Telefónica Group and others are pushing aggressively for rate rebalancing because it is their own financial self-interest to do so. The Commission is much more likely to succeed in its quest for lower settlement rate reductions if it aligns its goals to those of

the foreign carriers than if it attempts to impose its will unilaterally on the rest of the world in a manner that fails to recognize the existing economic and political realities in many foreign countries.

Indeed, MCI, WorldCom, and Sprint have recently entered into agreements with Telintar that demonstrate the benefits of tying settlement rate reductions to rate rebalancing.[117/] These agreements provide initially for a reduction in the accounting rate from $1.43 to $1.35.[118/] However, the agreements provide for much more significant future reductions in accounting rates tied to rate rebalancing that permit Telintar to reduce rates on the Argentina-U.S. route pursuant to the following schedule, as shown in Table 2.

Table 2

Date	Accounting Rate	Telintar's Collection Charge Reduction Authorized For U.S.-Argentina Route
September 1995	$1.43	
August 1996	$1.35	
	$1.29	30%
	$1.11	40%
	$0.92	50%

These agreements serve the needs of both U.S. carriers and Telintar. U.S. carriers get contractual commitments for substantial rate reductions. Telintar agrees to make these substantial settlement rate reductions as soon as "a rate rebalancing [is] authorized by the Argentine Government. . . ."[119/]

[117/] MCI International, Inc. Letter to William Caton (Oct. 15, 1996) (ISP 96-W-393) ("MCI-Telintar Accounting Rate Agreement"); WorldCom, Inc. Letter to William Caton (Oct. 28, 1996); Sprint Letter to William Caton (Oct. 15, 1996).

[118/] This reduction follows additional modest rate reductions in each of the four previous years.

[119/] MCI-Telintar Accounting Rate Agreement at Attachment A.

AT&T criticized the MCI-Telintar agreement, asserting that "this additional term in MCI's agreement has no legal or practical value."[120/] This simply is not true. The agreement legally binds Telintar to reduce settlement rates significantly when the Argentine Government permits rate rebalancing.[121/]

AT&T also incorrectly complains that "any performance is entirely in the control and discretion of Telintar."[122/] Actually, it is the Argentine Government, not Telintar, that controls the future rate reductions. Telintar, Telefónica Argentina, and Telecom Argentina have been urging the Argentina government for years to adopt broad rate rebalancing. It is in Telintar's own financial interest to reduce collection rates on the Argentina-U.S. route as quickly and substantially as possible because Telintar is facing considerable competition from call-back services.[123/]

To conclude, any mandatory settlement reduction policy must be tied to rate rebalancing. Such a policy would recognize that foreign carriers need

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120/ See AT&T's Opposition to Request by MCI for Waiver of International Settlements Policy to Implement Change in Accounting Rate for Switched Voice Service with Argentina at 2 (Nov. 5, 1996) (ISP 96-W-393). AT&T also opposed the WorldCom-Telintar accounting rate agreement.

121/ As these Comments were being finalized, the Argentine Government released complex new regulations which, among other things, implements rate rebalancing. Telefónica Internacional will address this rate rebalancing, and its effect on settlement rates, in its Reply Comments.

122/ Id.

123/ In addition to the explicit tying of settlement rate reductions to rate rebalancing in Telintar's agreements with MCI and WorldCom, foreign carriers in numerous other countries have implicitly tied settlement rate reductions to collection rate reductions. For example, on the United States-Chile route, CTC Mundo's accounting rate has fallen from $1.70 in 1993 to $1.10 in 1996 while the collection rate has also been reduced from $1.70 in 1993 to $1.10 in 1996. Similarly, Telefónica de España reduced its Spain-U.S. settlement rate 35% between 1994 and 1996 as it reduced its collection rate by 40%. For 1997, Telefónica de España has proposed further settlement rate reductions of 32% along with collection rate reductions of 25%.

governmental approval of rate rebalancing in order to reduce settlement rates significantly, and that foreign governments face conflicting political and economic goals. In addition, such a policy would align the Commission's goal of reducing settlement rates with the foreign carrier's goal of obtaining authorization for rate rebalancing.

VI. THE COMMISSION'S METHODOLOGY FOR DETERMINING ITS PROPOSED BENCHMARKS IS INCOMPLETE, INACCURATE AND INEQUITABLE

The FCC's methodology for determining its proposed benchmarks is flawed in two significant respects. **First**, the FCC's methodology does not fully or accurately reflect the legitimate costs of providing international service. **Second**, the FCC's methodology calculates these benchmarks in a way which significantly underestimates the costs of developing countries, while overestimating the costs of highly developed countries. This method produces benchmarks which not only bear no relationship to costs, but are sharply skewed against the developing world.

A. The FCC's Methodology Does Not Fully Or Accurately Reflect The Costs Of Providing International Service

The FCC's proposed method for determining benchmarks does not fully or accurately reflect the costs of foreign carriers because: (1) it excludes significant, legitimate costs faced by foreign carriers; (2) it is based on figures which do not themselves accurately reflect individual countries' costs; and (3) it is based on a number of inaccurate assumptions regarding switched traffic prices, circuit efficiency, and multiplication. The result is arbitrary benchmarks which, while lower than the current benchmarks, bear no relationship whatsoever to the real costs of providing international service.

1. The FCC's Methodology Fails To Include The Costs Of Providing Universal Service

The FCC's proposed methodology does not fully reflect the costs of providing international service because it omits the costs of providing universal service. Specifically, the FCC's proposed method relies on just three categories of costs: (1) international transmission; (2) international switching; and (3) national extension.[124/] Thus, the Commission omits the critical universal service costs. Even the OECD includes universal service as one of the four, not three, constituent costs of providing international service: (1) international transmission; (2) international switching; (3) national extension; **and (4) universal telephone service obligations**.[125/]

Universal service is extremely important, particularly in the developing world, where "the telephone service is still far from universal and the more sophisticated forms of telecommunications are almost unknown, except in some of the larger towns and business centres."[126/] This is in stark contrast to the developed world, where universal service is realistically within reach. For example, there were 68.2 telephone lines per 100 inhabitants in Sweden in 1992, 56.5 telephone lines per

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[124/] NPRM ¶ 35; International Bureau Report at 4. The ITU Recommendation which the Commission follows acknowledges that "the costs incurred in providing telecommunications services, although based on the same components, may have a different impact depending on the country's development status." ITU Recommendation D.140 at Annex A.2.2.

[125/] OECD, International Telecommunication Pricing Practices and Principles: A Progress Review 37 (1994) ("OECD Report").

[126/] International Telecommunications Union, Follow-Up Study of the Costs of Providing and Operating International Telephone Service Between Industrialised and Developing Countries, WATTC '88 Resolution PL/3, at 9 (1988) ("ITU International Telephone Service Cost Study").

100 inhabitants in the United States in 1992, but only 2.9 telephone lines per 100 inhabitants in Peru in 1993.[127/]

This imbalance between the developed and developing worlds is described vividly by the ITU in its International Telephone Service Cost Study:

> In the industrialised world, telecommunication is taken for granted as a key factor in economic, commercial and social activity and as a prime source of cultural enrichment. . . . Telecommunications are recognised as the indispensable arterial system of the information society. . . . The situation in the developing world is in stark contrast. In a majority of developing countries the telecommunications system is inadequate to sustain essential services. In large tracts of territory there is no system at all. Neither in the name of common humanity nor on grounds of common interest is such a disparity acceptable.[128/]

The figures are startling in absolute terms as well. As both the ITU and the FCC itself have noted, two-thirds of the world's population have no access to telephone services.[129/] As Vice President Gore put it, "the 24 countries of the OECD have only 16% percent of the world's population. But they account for 70 percent of the global telephone mainlines. . . ."[130/]

Vice President Gore further recognized the importance of ensuring global universal service when he stated:

> The final and most important principle is to ensure universal service so that the Global Information Infrastructure is available to all members of our societies. . . . We must ensure that whatever steps we take to expand our worldwide telecommunications infrastructure, we keep that goal in mind. Although the details of universal service will vary from

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[127/] Communications Outlook 1995 at 40 (OECD, 1995) (Sweden and U.S. data). The Peru data came from Telefónica Internacional reports.

[128/] ITU International Telephone Service Cost Study at 9.

[129/] Id.

[130/] Gore ITU Speech at M-3.

> country to country and from service to service, several aspects of universal service apply everywhere. Access clearly includes making service available at affordable prices to persons at all income levels. . . . Another dimension of universal service is the recognition that marketplace economics should not be the sole determinant of the reach of the information infrastructure.[131/]

This statement recognizes not only the importance, but also the scope of universal service obligations. Universal service does not mean that only inhabitants of rich countries have access to a telephone. Nor does it mean that access must wait until the marketplace provides it. To the contrary, universal service means that everyone, rich and poor alike, should have access to a telephone even if this entails government intervention in the market. This is a point that the United States itself has repeatedly recognized. Indeed, even the new Telecommunications Act, designed to increase competition in the U.S. market, maintains some universal service subsidies.[132/]

The key to achieving universal service is investment. Argentina and Peru are cases in point. In Argentina, the domestic carrier in the South, Telefónica de Argentina, has invested more than $3.8 billion in infrastructure since 1990.[133/] As a result of Telefónica de Argentina's efforts since 1990, the number of installed lines reached 3,292,456 in mid-1995, an increase of 1,915,000 lines (72%) since the privatization.[134/] Additionally, 38,673 pay telephones are now installed (an increase of 203%). Telefónica de Argentina has also substantially increased the quality of the

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131/ Id. at M-3.

132/ 47 U.S.C. § 254.

133/ Graciella Ezcurra, Carlos Gutierrez, Argentina -- Telecommunications Equipment and Services, U.S. Department of Commerce International Trade Administration Doc. ID IS9507.596, at 4 (Oct. 19, 1995).

134/ Id.

network in its region. Notably, there are now 2,111,125 digitalized lines (an increase of 655%) and 220,360 km of fiber optic cables.[135/]

Telefónica de Argentina plans to continue its significant capital investment. Telefónica de Argentina's new President, Javier Nadal Ariño, recently announced plans that include an additional $5.6 billion in investment before September 1998.[136/] Telefónica de Argentina's goals are to reach 100% digitalization of the network and 23 lines installed per 100 inhabitants by that date.[137/]

In Peru, Telefónica del Perú is contractually obligated to make substantial investments to improve and modernize Peru's telephone system. Among other things, Telefónica del Perú is committed to installing 1.2 million new lines by the year 2000, while replacing some 200,000 existing lines. Other commitments include: (1) reducing waiting times for telephone service to 90 days for 80% of customers by 1998; and (2) tripling the number of payphones so that all villages of at least 500 persons has a payphone.

Telefónica del Perú is already more than fulfilling its obligations. For example, Telefónica del Perú installed approximately 1,010,822 lines between 1993 and 1996, reducing the waiting time for telephone service has fallen from 70 to 1.5 months. Additionally, by the end of 1996 -- after less than three full years of privatization -- telephone penetration increased from 2.9 to 5.9 lines per 100 inhabitants. Telefónica del Perú agreed to install an additional million new lines by 2003, which should increase telephone subscribership to around 9 lines per 100 inhabitants.

135/ Id. at 4-5.

136/ Id.

137/ Id.

Increased investments in the telephone network benefit everyone on the network, including U.S. consumers and industry. For example, between 1993 and 1996, Telefónica del Perú's substantial investments increased the percentage of calls from the United States to Peru that were completed from 35% to 51.5%. Moreover, between 1994 and 1996, traffic minutes from Peru to the United States increased by 75%, while calls from the United States to Peru increased only 51%. U.S. consumers benefited from these much larger traffic flows between the United States and Peru. More significantly for this proceeding, the U.S. settlements imbalance was reduced because these investments made it possible for more Peruvians to call the United States.

Clearly, the investments of Telefónica de Argentina and Telefónica del Perú demonstrate that rapid development and the fulfillment of universal service obligations do not come cheap. Such ambitious goals require the commitment of significant resources. These resources represent a very real cost of providing service and increasing economic efficiency in developing countries, and one that must be taken into account when making comparisons between the developing and the developed worlds.

Given the huge undertaking that universal service represents, and the stunning disparity between the developed and developing worlds, the FCC should, at a minimum, adjust its methodology to include a universal service cost component.

Indeed, if the Commission believes that settlement rates should be based on costs, then it should consider a system of asymmetrical settlement payments which reflects differences in universal service costs. Under this approach, in any given bilateral agreement, the more developed country would be required to pay a higher rate to terminate traffic in a less developed country. On the other hand, the correspondent from the less developed country would be able to terminate the return traffic at a lower

rate. Such a system would recognize the underlying economic realities: developing countries have higher costs than developed countries. Such a system would go a long ways toward correcting one of the most serious flaws in the FCC's proposal.

2. The FCC's Methodology Does Not Accurately Reflect The Costs Of Providing International Service

Additionally, the FCC's proposed methodology does not accurately reflect the costs of providing international service. In particular, the Commission does not have, and thus cannot use, the country specific data which would make such calculations reasonable estimates of cost. It simply assumes that, because the sum of the tariffed prices for identified components are lower than current settlement rates, they are an appropriate proxy for actual costs.[138/] This simply is not the case. Indeed, the FCC itself acknowledges that in many countries, tariffed prices bear no relationship whatsoever to costs.[139/]

Moreover, since many countries use funds from international services to subsidize domestic services, the tariffed rate for the national extension component is, in some cases, significantly **lower**, not higher, than true costs. Indeed, Barbados, Hong Kong, and Kuwait all tariff national extension at $0 -- which must, of course, be well below their costs.[140/] As noted above, at least some of the 56 out of the 65 countries in the International Bureau Study that have average long distance prices lower than the United States use long distance services to cross-subsidize local services. These countries clearly place a high priority on making affordable domestic telephone service available. Just as clearly, the FCC's methodology penalizes these countries for doing so.

138/ NPRM ¶¶ 40-42.

139/ Id. ¶ 45.

140/ Id. at Appendix B.

The FCC then compounds its error by proposing to average Tariffed Component Prices ("TCPs") across countries instead of using country-specific benchmarks. Such averaging is particularly inappropriate given that the costs at issue vary significantly even between countries that are within the same category of economic development. As the OECD has recognized, such variations can be caused by a host of factors, including differences in the construction costs (e.g., capital costs (which are almost always higher in developing countries)); national differences in the uptake of new technologies; national geographic differences and demand characteristics; differences in national regulatory environments; and differences in operator efficiencies.[141/]

Potentially even more significant is the huge variability in political and economic risk across countries in the developing world. Investments in these countries frequently face significant risks from political and economic upheaval, such as terrorism, property nationalization and significant currency instability. Such phenomena are unique to each country and can neither be discounted nor generalized. The NPRM, however, does nothing to account for the different risks to investing in telecommunications networks in London, England and Lima, Peru.

The NPRM defends its choice of averaging over country-specific benchmarks on two grounds, both of which are unconvincing. **First**, it states that "an average figure is beyond the ability of any one carrier to alter significantly, so a carrier will have no incentive to change its tariff rates to affect the level of its benchmark."[142/] Yet this problem can be readily solved by an FCC decision not to recognize significant increases in the underlying TCPs if it finds that those increases are solely intended to raise the benchmark.

[141/] OECD Report at 37-38.

[142/] NPRM ¶ 46.

Second, the NPRM states that "a potential problem of setting country-specific benchmarks based on the tariffed components prices of each country's carrier(s) is that it results in different benchmarks for similarly situated countries."[143/] Yet, as just discussed, countries that are similarly situated in terms of levels of economic development may nevertheless face vastly different challenges within their telecommunications sectors. In other words, the Commission's averaging proposal does not, in fact, group similarly situated countries. On the other hand, it would be quite simple, and not significantly more burdensome administratively, for the Commission to use country specific benchmarks.

3. The Commission's Methodology Is Based On A Number Of Faulty Assumptions

Even if the Commission's decision to used tariffed prices as a proxy for foreign carriers' costs were acceptable, its method of calculating costs based on these prices is not. In particular, the International Bureau's Study bases its calculations on a number of assumptions which can at best be described as arbitrary, including: (1) that the use of private circuit prices is an appropriate estimate for switched traffic prices; (2) that a 4:1 multiplication ratio is appropriate for all carriers; and (3) that 8,000 minutes per circuit per month is a reliable estimate of usage on all routes. As the following paragraphs show, each of these assumptions are seriously flawed.

a. The FCC Cannot Reasonably Use Private Circuit Prices As A Proxy For Switched Traffic Prices

The Commission incorrectly assumes that the tariffed prices for private circuits are an appropriate proxy for switched traffic.[144/] Private line traffic and switched traffic are subject to entirely different sets of risks and returns. Thus, while the costs of

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143/ Id. ¶ 55.

144/ NPRM ¶ 37.

the underlying physical facilities may be the same, the operational costs associated with switched traffic are significantly higher than the costs associated with private line traffic. This is because switched traffic usage is more variable and thus subject to greater risk. There is very little risk for private line traffic because the carrier receives a fixed, flat rate. As with any business, the risks are necessarily a factor in determining price, with a lower price reflecting the lower risk. Thus, the costs of leasing private lines is necessarily going to be lower than the costs of operating public lines. And lower costs translate into lower prices. In other words, the tariffed prices for private lines reflect lower risks and lower costs. They are thus an inaccurate and inappropriate proxy for determining the costs for providing public switched service.

b. The FCC's Assumption That A 4:1 Multiplication Factor Is Appropriate For All Carriers Is Wrong

The NPRM's assumption that a 4:1 multiplication factor is appropriate for all traffic for all carriers is wrong. The NPRM assumes that "because the general practice among U.S. carriers is to derive four voice grade circuits from a 64 Kbps half-channel," that this is the general practice among all other carriers.[145/] This is simply not the case.

The extent of multiplication depends on a variety of factors, such as the type of traffic and the type of circuits. For example, the use of analog circuits means there is no multiplication factor. Similarly, no multiplication factor (or at least a lower one) must be used for non-IMTS traffic. Indeed, the multiplication factor employed in routes with high data and facsimile traffic is closer to 2:1. The FCC's assumption makes no provision for such common variations.

[145/] International Bureau Study at 8.

c. The FCC's Assumption Of 8,000 Minutes Per Circuit Per Month Inaccurately Reflects Usage On Developing Country Routes

While the Commission acknowledges that "[m]onthly minutes transmitted over international circuits vary from country to country, from carrier to carrier, and from month to month," it nevertheless goes on to conclude that "about 8,000 minutes of voice traffic per circuit per month represents a reliable and reasonable usage level for the countries included in the study."[146/] While 8,000 minutes of voice traffic per circuit per month may be a reliable high-end estimate of usage between highly developed countries, the amount of voice traffic between the United States and the Telefónica Group countries, on average, is approximately 7,000 minutes per circuit.

Using the Commission's own example of France, it becomes obvious that any variation in usage can make a considerable difference in the ultimate monthly tariff rate.[147/] Specifically, with a usage of 7,000 minutes per circuit, per month, France's monthly tariff rates jumps from $0.029 to $0.033 -- a difference that should not be assumed away.

B. The FCC's Methodology Skews The Benchmarks Against Most Foreign Countries

The NPRM's methodology for determining benchmarks is also problematic because it relies on exchange rates to produce accurate U.S. dollar equivalents of prices tariffed in foreign currencies.[148/] The World Bank, however, has explained that "[t]he use of official exchange rates to convert national currency figures to U.S. dollars does not reflect the relative domestic purchasing powers of

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146/ Id. at 8.

147/ Id.

148/ NPRM ¶ 55.

currencies."[149] This is not an insignificant problem. When used to compare the prices of goods or services that are not widely traded internationally, such as domestic long distance services ("national extension"), exchange rates produce benchmarks which significantly underestimate the costs of most countries -- and overestimate the costs of highly developed countries. Such an error can readily be corrected by using the World Bank's Purchasing Power Parity ("PPP") conversion factors rather than exchange rates to convert foreign currencies into U.S. dollars.[150] It is the standard practice of the United Nations, World Bank, International Monetary Fund, and OECD to use PPP to make international cost comparisons.[151]

The World Bank's PPP conversion factors are designed to correct a commonly observed phenomenon created by exchange rates: while a U.S. dollar should buy the same amount of goods or services in, say, Peru or Switzerland as it does in the United States, it does not. In fact, a U.S. dollar buys more goods or services in Peru and fewer goods and services in Switzerland. This is not because the real costs of the goods and services are lower in Peru and higher in Switzerland, but because exchange rates do not accurately reflect the underlying costs of goods that are not widely traded internationally.

In other words, exchange rates can be used to compare the prices, denominated in different currencies, of goods and services, such as a barrel of crude oil, that are traded on the world market and thus have a "world price." Exchange rates

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[149] World Bank, World Development Report 1993: Investing in Health at 307 (World Bank, 1993) ("1993 World Bank Development Report"). See also World Bank, From Plan to Market, World Development Report 1996 at 188-89, 225 (World Bank, 1996) ("1996 World Bank Development Report").

[150] PPP conversion factors were developed by the U.N. International Comparison Programme. 1993 World Bank Development Report at 306-08.

[151] Id. at 308.

cannot be used to accurately make such a comparison for goods and services that are not traded on the world market and thus have only a national price.[152/] However, the PPP conversion factor, defined "as the number of units of a country's currency required to buy the same amounts of goods and services in the domestic market as one dollar would buy in the United States,"[153/] can be used to make such a comparison. PPP works by adjusting the price level upwards in countries, like Peru, whose costs are higher than they appear, and adjusting the price level downwards in countries, like Switzerland, where costs are lower than they appear.

Table 3 illustrates the problems inherent in using exchange rates when comparing developed and developing countries by calculating the TCPs with the PPP adjustment for national extension and international switching, the two components of the FCC's TCPs which are not internationally-traded services and thus require PPP adjustments.[154/] These services are provided only in a terminating country -- they cannot be "sold" in another country. They thus have only a "national" price.[155/]

[152/] See e.g., Paul R. Krugman & Maurice Obstfeld, International Economics 414, 417-19 (3d ed. 1992).

[153/] 1996 World Bank Development Report at 225.

[154/] Id. at 188-89.

[155/] By contrast, there is an "international" price for international transmission services since the same international satellite and cable facilities are used to serve multiple countries.

Table 3									
	PPP Conversion	National Extension		International Switching		International Transmission		TCPs	
Country		FCC	PPP	FCC	PPP	FCC	PPP	FCC	PPP
Peru	1.71	$.055	$.094	$.048	$.082	$.058	$.058	$.161	$.234
Czech Republic	2.78	$.081	$.225	$.048	$.133	$.005	$.005	$.120	$.363
El Salvador	1.77	$.059	$.104	$.048	$.085	$.011	$.011	$.118	$.200
Egypt	2.40	$.104	$.250	$.048	$.115	$.020	$.020	$.172	$.385
Austria	0.79	$.081	$.064	$.019	$.015	$.214	$.214	$.314	$.293
France	0.84	$.029	$.024	$.019	$.016	$.127	$.127	$.175	$.167
Japan	0.61	$.113	$.069	$.019	$.012	$.065	$.065	$.197	$.146
Switzerland	0.66	$.143	$.094	$.019	$.013	$.044	$.044	$.206	$.151

As Table 3 shows, the NPRM's method suggests that the costs of providing international service in highly sophisticated and developed countries such as Japan ($0.179) and Switzerland ($0.206) are higher than the costs of providing such service in the Czech Republic ($0.12) and El Salvador ($0.118), where telephone companies are plagued with lower teledensity, high capital costs, high universal service obligations, greater political risks, and other difficulties. Basic trade theory tells us that, where such differences in costs exist, the NPRM's calculation of higher costs for Japan than El Salvador cannot be right.[156/] PPP tells us why, in fact, the NPRM's calculation is wrong: the NPRM's method significantly underestimates the costs of carriers in most countries, while overestimating the costs of carriers in highly developed countries.

To correct for this error, any use of TCPs to compute benchmarks must be adjusted by the PPP, as shown in Table 3. The "PPP Conversion" is calculated as the ratio of the World Bank's PPP-adjusted GNP to GNP.[157/] The PPP conversion factor

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156/ See e.g., Krugman & Obstfeld, International Economics 64-75.

157/ 1996 World Development Report at 188-89.

is then multiplied by the national extension and international switching costs identified in the NPRM for each country. The results are then added, together with the costs of international transmission, to obtain a PPP-adjusted TCP. If the Commission proceeds with a unilateral "cost-based" methodology, then it must use the PPP to adjust the benchmarks in order to reflect the real costs of providing international termination services.

VII. THE NPRM TRANSITION SCHEDULE IS OVERLY BURDENSOME AND INTRUSIVE

The NPRM proposes a transition schedule that is overly burdensome and intrusive for most countries. Specifically, the NPRM proposes that high-income countries achieve the proposed rates within one to two years, middle-income countries within two to three years, and lower-income countries within four to five years.[158/] At the same time, the Commission proposes to categorize a large number of developing countries, such as Peru, where 45.3% of the population is living in poverty, as "middle income." This leaves only the very poorest countries, such as Ghana, in the lower-income category. Because the overwhelming portion of U.S. outgoing traffic is with countries in the middle-income and upper-income categories, virtually all of the traffic could be at the proposed benchmark levels within only two years.

Nevertheless, the NPRM claims that these deadlines will provide sufficient time for carriers and countries to make any necessary adjustments. The NPRM states:

> We nonetheless realize that countries will need time to make the adjustments necessary to introduce competitive reforms. We also recognize additional time may be needed to enable U.S. carriers to negotiate for lower settlement charges with their foreign correspondents without forcing undue disruption of both parties' operations. For example, carriers in many developing countries have significantly distorted

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158/ NPRM ¶ 63.

> rate schedules involving cross-subsidies from users of international services to those using domestic services. These carriers also may have substandard telecommunications infrastructure, including low levels of network buildout and low levels of network reliability. An immediate shift to cost-based settlement rates thus could create adjustment problems for carriers in these countries while they are trying to rebalance rates and upgrade their network.[159/]

Despite this statement, the NPRM's transition schedule is surprisingly short, demonstrating a huge gap between the NPRM's rhetoric and a real understanding of the terms of existing settlement contracts, the difficulties inherent in negotiating new contracts, and the extent of the domestic adjustments that many countries will have to make in order to comply with the benchmarks. This is particularly remarkable in light of the "limited competition"[160/] in the U.S. IMTS market which still provides enormous price-cost margins to U.S. international carriers fifteen years after the AT&T decree.

As discussed above, settlement rates are contractually negotiated. At the very least, the Commission should establish a transition schedule which respects existing contracts. Moreover, any schedule should additionally take into account the difficulties inherent in negotiating new contracts, which frequently take over a year to finalize.

In addition, settlement revenues are a significant funding source for vital infrastructure improvements in many countries. Until an alternate source of funding is identified, it is not realistic to expect this source to dry up so quickly. Nor is it desirable. Without the funds necessary to modernize their telecommunications sectors, many developing countries will delay, not accelerate, the introduction of competition. This, in turn, will delay achievement of the actual cost reductions that in many cases are a

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159/ NPRM ¶ 61.

160/ NPRM ¶ 9.

necessary precursor to settlement rates that are not only lower, but are also sustainable.[161/]

Most importantly, as explained in Part V above, many countries will have to rebalance rates domestically before they can significantly reduce their settlement rates. This is a highly sensitive internal political issue, which neither the FCC nor a foreign carrier can control. Rather, foreign governments control this critical timetable. As discussed above, countries around the globe face different and difficult challenges in creating modern, competitive telecommunications markets. Policies to meet these challenges must be met by their own governments, not the FCC. Accordingly, the only acceptable timetable is one that is tied to rate rebalancing.

If the Commission persists in moving ahead without regard to rate rebalancing, then it should at least double its proposed transition schedule for developed countries. Even more transition time is needed for developing countries -- which include the countries in the Commission's lower-middle income category -- where the problems inherent in the Commission's schedule are most evident.

The Commission may be concerned that foreign carriers will not use additional time to invest in telecommunications infrastructure. If this is the case, there are steps the Commission can take to ensure this does not occur. For example, the Commission could tie the additional time to infrastructure investments that exceed the settlements imbalance with the United States. Such a safeguard would ensure that settlements imbalances were used to improve the network, which will promote universal service and encourage more inbound calls to the United States.

[161/] For the same reasons, the Commission should not have interim transition rate goals. Again, it is inevitable that countries will proceed towards lower accounting rates -- and competition generally -- based on domestic considerations that vary considerably. The FCC cannot possibly expect countries to address such considerations either instantly or uniformly.

VIII. THE COMMISSION SHOULD NOT APPLY ANY BENCHMARKS TO COUNTRIES COMMITTED TO COMPETITIVE REFORM

The Commission should not apply any benchmarks to countries that are either already open to competition, or to lower middle income and lower income countries that are firmly committed to do so by a date certain. As the Commission notes:

> [W]e believe the best way to create an alternative to the traditional accounting rate system is to introduce effective competition. Indeed, we believe that in competitive markets our benchmark rates would not be necessary because international call termination rates in such markets will be below any benchmark rates that we adopt.[162/]

Not only would a Commission decision to impose new benchmarks on these countries be unnecessary, but it could even interfere with the functioning of the marketplace and inhibit the development of full competition. As the Commission stated in its recent Flexibility Order with respect to other aspects of the ISP, "where markets are becoming competitive, the ISP's requirements . . . may impede competitive behavior and the development of effectively competitive markets."[163/] The imposition of an artificial benchmark on nascent competitive markets would be no less stifling.

The Commission should thus, as it suggests, refrain from imposing its new benchmarks where countries are open to competition. In that regard, the Commission's equivalent competitive opportunities ("ECO") test should be used to make the necessary assessment. Additionally, the Commission should also refrain from imposing its new benchmarks on developing countries -- including those in the

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[162/] NPRM ¶ 69.

[163/] Flexibility Order ¶ 37.

lower-middle income category -- that have set a date certain for introducing competition.

A. The Commission Should Not Apply Benchmarks To Countries Which Satisfy The ECO Test

The Commission should not apply its proposed benchmarks to countries which are sufficiently opened to competition to satisfy the Commission's ECO test. The ECO test is designed to determine whether a country's telecommunications market is open to competition, and competition alone should be the ultimate determinant of the need to adjust accounting rates in these countries.

As discussed above, a competitive market will itself lead to lower accounting rates. Indeed, the Commission has acknowledged this causal relationship in its Market Entry Order, when it declined to make cost-based accounting rates a part of its ECO test. In doing so, it stated:

> We believe that additional service providers will increase supply options, and lower foreign calling prices. These actions should stimulate demand, and increased usage of fixed plant should reduce the carriers' average unit costs. In addition, greater demand may increase net revenues thereby reducing foreign carriers' need to rely on settlement payments to finance investment and enabling reductions in the level of accounting rates. Thus, increased global competition will encourage foreign carriers to move accounting rates towards cost-based levels. We therefore believe it would be counterproductive to require cost-based accounting rates as a precondition to foreign carrier market entry.[164/]

[164/] In the Matter of Market Entry and Regulation of Foreign-affiliated Entities, 11 FCC Rcd. 3873, 3899 (1995).

Most recently, in its Flexibility Order, the Commission reiterated its belief that the ECO test provided a good measure of a country's competitive health: "We believe that, where the ECO test has been satisfied, the ability of foreign carriers to exercise market power is constrained by the existence, or potential for, competitive entry."[165/] The Commission accordingly concluded that it would permit U.S. carriers to negotiate alternative payment arrangements with any carrier in a foreign country that satisfies the ECO test. The same rationale applies with respect to the Commission's proposed benchmarks: a telecommunications market that is competitive enough to satisfy the Commission's ECO test does not need the FCC to set artificial benchmarks to ensure that its accounting rates are themselves competitive. What it does need is the ability to let competitive forces set the terms of settlement arrangements.

Chile provides a case in point. In many respects, Chile is one of the most competitive telecommunications markets in the world, a reality that the Commission has itself recognized on several occasions.[166/] Chile satisfies the Commission's ECO test in

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165/ Flexibility Order ¶ 39.

166/ See In the Matter of Melbourne International Communications, Ltd., File Nos. 1940 DSE-TC-96(2), I-T-C-96-492(TC) (rel. Jan. 21, 1997) ("Chile offers effective competitive opportunities in the licensing and operation of earth stations."); In the Matter of AmericaSky Corp., File No. 1821-DSE-TC-96(3) (rel. Dec. 6, 1996) ("Chile's laws and regulatory regime permit U.S. entities to be licensees and operators of international and domestic long distance satellite earth stations in Chile and safeguard against anticompetitive conduct, including discrimination against foreign-owned carriers."); In the Matter of NACS, Inc., File No. ITC-94-434 (rel. Sept. 27, 1996); In the Matter of AmericaTel Corp. Application for Transfer of Control and Pro Forma Assignment of Section 214 Authorizations, 9 FCC Rcd. 3993 (1994) (approving Entel Chile's acquisition of 60% of Northland); NACS Communications, Inc., 10 FCC Rcd. 13062 (1995) ("Chile's markets for domestic long distance and international services are becoming more competitive and open to U.S. investment and participation."); AmericaTel Corp., 10 FCC Rcd. 12157 (1995) (granting AmericaTel's Section 214 application to acquire facilities for service between the United States and Canada and Mexico because of Chile's liberalized telecommunications market); AmericaTel Corp.,

(continued ...)

every respect.[167] Most significantly, Chile clearly provides U.S. carriers with the ability to enter the Chilean market and provide international facilities-based service. This ability is more than just a legal right. U.S. carriers are in fact already fully participating in the Chilean market. For example, out of the eleven carriers authorized to provide international services, three have significant U.S. ownership: BellSouth Chile (BellSouth), VTR Telecomunicaciones (Southwestern Bell), and Iusatell (Bell Atlantic).

Yet, despite this highly competitive environment, settlement arrangements in Chile are still subject to the Commission's ISP. It is this regulatory intervention, which has prevented U.S. and Chilean carriers from competing for settlement terms. The Commission's Flexibility Order should go a long way towards remedying this problem. By allowing carriers to compete for settlement terms, this Order will allow the market forces at work in the Chilean and U.S. markets to be the final arbiter of settlement terms. If AT&T does not like the settlement rates offered by CTC Mundo or EntelChile, it can try to obtain a more competitive rate from BellSouth Chile or one of the other U.S.-affiliated Chilean carriers. Or, AT&T can freely enter the Chilean market and terminate U.S.-Chile traffic itself.

In short, competition, not unilateral regulatory decree, should determine settlement rates on competitive routes, like the U.S.-Chile route.

166/ (... continued)
10 FCC Rcd. 2901 (1995) (granting AmericaTel's Section 214 application to supplement existing facilities between the United States and various foreign countries because of Chile's progress in liberalizing its telecommunications markets).

167/ See, e.g., In the Matter of Melbourne International Communications, Ltd., File No. 1940 DSE-TC-96(2) ("Chile offers effective competitive opportunities in the licensing and operation of earth stations."). See also In the Matter of AmericaSky Corporation, File No. 1821-DSE-TC-96(3).

B. The Commission Should Not Condition The Authorizations Of Foreign-Affiliated Carriers On Settlement Rates Within The Commission's Proposed Benchmarks

There is no need for the FCC to condition the authorizations of foreign-affiliated carriers on settlement rates within the Commission's proposed benchmarks. Such carriers and their foreign-affiliates do not have any incentive to act anti-competitively. More specifically, and contrary to the arguments of some U.S. carriers, there is simply no incentive for foreign carriers to cross-subsidize their U.S. affiliates, regardless of whether the accounting rates are above-cost or not. As the FCC has already correctly observed:

> This argument . . . appears to ignore the opportunity costs to the foreign parent of offering service through an affiliate in competition with U.S. carriers that formerly purchased termination service from the parent. In serving its home market directly through its affiliate, the foreign parent would no longer receive the settlement payment it formerly received from U.S. carriers to terminate traffic in that market.[168/]

In other words, because a foreign carrier that offers service through a U.S. affiliate loses settlement payments that it would otherwise receive from U.S. carriers, it gains no particular advantage.

C. The Commission Should Not Apply Benchmarks To Developing Countries That Have Set A Date Certain For Introducing Competition

The Commission should also forbear from imposing its benchmarks on Lower Middle Income and Lower Income countries that have set a date certain for introducing competition. Such forbearance is warranted for two reasons. **First**, these countries have committed to introducing the competition that will ensure that settlement rates will become cost-oriented in the near future -- in many cases within the transition

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168/ NPRM ¶ 80.